EX PARTE OR LATE FILED

Anna-Maria Kovacs
First Vice President-Research
Janney Montgomery Scott
60 State Street
Boston MA 02109

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Mr. Andrew Fishel Managing Director Federal Communications Commission 1919 M Street NW, Room 852 Washington DC 20554

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APR 1 1 1997

April 8, 1997

Federal Communications Commission Office of Secretary

EX PARTE:

Access Charge Reform CC Docket 96-262/

Federal State Joint Board on Universal Service CC Docket 96-45

Dear Mr. Fishel,

On February 26, 1997 a group of financial analysts, Frank Governali of Credit Suisse/First Boston, Richard Klugman of Goldman Sachs, Peter Kennedy of Morgan Stanley, Charles Shelke of Smith Barney, and I, met with Tom Boasberg, Robert Pepper, Greg Rosston, Jon Garcia, Elliot Maxwell, of the FCC staff and FCC Chairman Reed Hundt to discuss recent presentations by telecommunications companies to Wall Street analysts and investor expectations of upcoming regulatory decisions in the access charge reform and universal service dockets listed above. I have enclosed copies of the publications that the analysts issued subsequent to the meeting. In accordance with the Commission's rules, an original and two copies of this notice are being filed.

Please let me know if you have any questions.

Sincerely yours,

Jua Marie Toure

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Via Pax

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Morning

Meeting

Comments

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ALL GROWN WOODLAN

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unbundling, and intercentraction. He realitymed his commitment to universal tervice, and his ballef that the best way to activeve that is to enable new entrants to share incumbents' facilities via resale. (NPRM, 12/24/96). He stated that he considers infrastructure competition most desirable, and buttore focused on some of the specific items that had been russed in the second Notice of Proposed Rulemaking actes reform must be done simultaneously with universal estwice. Specifically he stated: in his speech, Chairman Hundt reiterned the principles of the August interconnection Order and

name FERC, flat equitable rate charge, for the flat rate. He suggested that it might be imposed more the Fund. He continues to be committed to restructuring access charges in accordance with underlying costs, conventing fixed costs currently recovered on a per-minute basis to flat rates. He suggested the net contributors to the Fund, and not helpful to others like bellsouther GTB that are large net takers from that is likely to result in a fairly small federal USF and to be helpful to companies like Americach that are gwelly ar to a greater degree on second residential lines or on multibusiness lines than an first residential litigation by focusing the faderal Universal Service Pand (USF) on interestate revenues only. We believe While he does not believe in separate federal and state Punds; he to inclined to avoid jurisdictional

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617 227 1571 AMMA-MARIA KOVACS

Page 203

PEBRUARY 27, 1867

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The group was split on our expectations of when 271 entry would occur, with most of us expecting most of the entry in '96. The supporters of Bell stocks were clear that their support of those stocks relies most on their belief that significant competition in the local market will develop slowly, much more slowly than the Bells' entry into long distance in-region.

What we believe the PCC took away from the meeting was a sense that access cuts in the \$1-3 billion range this year would be accepted calmly by the stock market, and that the FERC would be good for both local teleos and long distance carriers, but not for pure CAFs.

We continue to expect initial access cuts in the \$1-2 billion range, net of universal service funding. They may well focus more on the terminating than originating end. We expect additional prescriptive cuts over the next several years unless the market itself takes down access rights significantly. We expect a small federal USP.

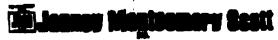
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Morning Meeting Comments

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TELECOM MOUSTRY

MOLATE

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In his speech, Cheirman Hundt reiterated the principles of the August Interconnection Order and focused on some of the specific items that had been raised in the species Notice of Proposed Rulemaking (NPRM, 12/24/96). He stated that he considers infrastructure competition most desirable, and believes the best way to achieve that is to enable new entrants to share incumbents' facilities via resale, unbundling, and interconnection. He reaffirmed his commitment to universal service, and his belief that access reform must be done simultaneously with universal service. Specifically he stated:

While he does not believe in separate federal and state Punds, he is inclined to avoid jurisdictional litigation by focusing the federal Universal Service Pund (USF) on interestate revenues only. We believe that is likely to result in a fairly small federal USF and to be helpful to companies like Ameritech that are not contributers to the Pund, and not helpful to others like Believethor GTE that are large not takens from the Pund. He continues to be committed to restructuring access charges in accordance with underlying costs, converting fixed costs currently recovered on a per-minute basis to flat rates. He suggested the name PEEC, flat equitable rate charge, for the flat rate. He suggested that it might be imposed more quickly or to a greater degree on second residential lines or on multibusiness lines than on first residential lines.

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MORGAN STANLEY Equity Research Briefing Note

MAIT, BEL, BLS. FON. GST. ICDX, ICG, IDXC, MCIC, MCLD. NYN. PAC, SBC, T, TCGI, USW. WCIL, WCOM. US Telecommunications Services (I/TEL): Meeting With the PCC Stephanic Comfort (303) 740-6695 Peter Kennedy (212) 761-8033

Date: March 5, 1997 Type: Industry Overview

KEY POINTS

Yesterday we man with the POC to discuss acress reform and universal service. The PCC was looking for Wall Secrets expectations and reactions to various outstants.

Although the process is still fluid, we believe this marting combined with our interpretation of Chairman Reed Hundt's recent speech to the National Association of Regulatory Utility Commissioners has given us a better sense, directionally, of where the Commission is going.

As you recall, the 1996 Telecom Act required that the Universal Freed, an explicit subsidy fund, be enhanced to support telecommunications services for low income howeholds, high cost areas and subvidize public schools, libraries esc. Today these subsidies are primarily achieved through implicit support machanisms (accous revogues). The goal of the PCC has been to matrusture the support mechanisms from implicit to estplicit subsidies. This is why access reform and universal service are so intertwined.

Access Referen.

According to FCC reports, in 1995 there was \$31B for in scens charges poid to the local exchange providers. This consists of \$7.18 in orderer revenue with the romaining \$24b from switched and special sectors. Switched access revenues are derived from originating and terminating per minute access charges paid by the inter exchange carriers (DKCs). Today, traffic market access rates are just below \$0.03 per minute. Those across rates have historically never been based on cost but have been uned to subcidize other high cost components of the local network. The FCC intends to drive inter-state access pane down to cost over some time period. With current estimates for forward

looking economic costs coming in at \$0.004-50.01. There is a significant gap between current tariffs and cost projecti bas.

We believe this reform will be realized through two methodi: restrictating and straight reductions.

Restructuring - One of alternatives mentioned was to convenivariable carrier common line (CCL) observe into fixed line charges. A pertion of account rates today (\$0.004-50.02) are what are known as cerrier common line charges. These charges were created to support the high cost of the local local. Although the charges are traffic sensitive, the actual class are not traffic sensitive and should indeed be a fixed cost. Instead of paying a per minute charge, LD providers will pay a fixed cost per pro-subscribed line.

Implications

- We billove this benefits Long Distance Providers especially those with high end customers. By piccing a greater partion of variable cost into fixed costs. Interest hange providers will be able to offer price incentives to stimillate volume demand while keeping a greater parties of the chest fixed.
- For the CLECS, we believe this is slightly positive in the short with. By placing more of the revenue into fixed per line reviewes, it disjacenes the cream akimming of high end
- This restructuring is slightly favorable for the RBOCs because this door distancest cream skimming but it also reduces the benefit of access volume growth in the acquork.

Reductions -

This memorandum is based on information are liable so the public. No reprocessation is made that is a sample or complete. This memorandum is not as offer to buy or sell or a collicionies of the offer to buy or sell the negatives mentioned. He offer Stanley & Co. Inc. and colour memorand with it may have positions in and offers transcribed in according to remaining the particular transcribed in according to remaining the processor in the process

We also believe there will be substantial reductors in access rates driving the traffic sensitive portion down to \$0.005-\$0.01 range over the heart three to five years. We believe that three rates will be reduced through a combination of regulatory our and prescribed minimums for market based reduction, with particular emphases on terminating access.

Implications

- Again this is a positive for the long distance providers to the extent retail prices remain science and do not decline as fast as seens.
- For the CLECs this is a slight nagative because of their multiposal CAP business which relied heavily on access rate. The CLEC or Dial tone business is less impacted because of the diverse revenue streams of lotal, roll and nature.
- The RBOCs should final pentages from any significant cuts in momen. It is their most profitable revegue, with 80% + margies. To the extent that the excess reductions are not supplemented with Universal Services payments, these reductions will virtually all full to the bottom line.

Universal Service Fund

The exact size of the final has yet to be descrizioned, but it appears to be submanufally less than the present implicit that. Currently the Commission estimates that there is \$238 in access charges that are flowing to lactaphent local exchange carriers (ILECs) from ECCs. The contention that has arisen is how much of the access revenues go towards real costs and how large should the new explicit subsidy by The ILECs believe they should be bupt whole or close to whole, while the ESCs think the explicit fund should be \$5-108. We believe the Stook is anticipating the fund will end up in the \$108-158.

The FCC is currently in negotiations with the State PUCs on just how to approach the final. Will there be two separate funds (form-state and hastware) or one large universal fund? The FCC's position today, is that unless there is consensus smoon the States, the FCC will just run un interruse universal fund and let the States fined for themselves on the shortfalls. We believe the FCC is a bit sty after the States shortfalls. We believe the FCC is a bit sty after the States

lawrestictower the intraconnection rules but we sign believe this is a bit of posturing by the RCC. The rural states with less telecommunications revenues and higher coars structures would be better off with one Federal Fund.

Because of the revenue concentration in the top 10 states, we believe that the majority of States would benefit from one certail fund.

Fixed Charge - With the raductions in access, the FCC has to derive another payment meethenism to support the universal fund. The machenism thet is currently being discussed is a flat rate, called the flat and equitable rate charge (FERC), based on pre-subscribed libes. The charge will probably not be equal for all libes, multi-libes and second libes will probably have premiums attached.

FCC uses Interests Revenues to Fund the Fuderal Portion of Universal Funds. If the FCC goes with only Interestate revenues, no local or instructor revenues will be affected (taped) by the FCC Fund.

No. IT

If the PiC remains on its present track, with the interstant fund only, we could see the ILECs' subsidy pool shrink by \$550 to \$100 over the mast five years. This does not account for any classicity/growth in the market or any State support machanisms.

E

LD players appear to be the winners in access reference. Although the timing and conguireds is still unclear, we believe that not payments to the ILECS will decided.

We see the impact to the CLECs as slightly negative but above expecuations. The CLECs will be impacted by access reductions, but these reductions will be phased in rad will be more focused on the terminating access reductions which impact he ILECs more then the CLECs. In regards to universal services contributions, if the FCC decides on an intervals fund only, CLECs will not have to contribute may revenue from its core base. Those CLECs with a large portion of LD revenues will be beautifulate of this reform.

This measuration is based on information sectionic to the public. No representation is affect to buy or self or a self-clustess of the offer to buy or self the accertifies measurated. I positions to and affect transactions in securities of companies providental and may alex principalitation is related to the state of is execute or complete. This magnetistics is any large & Co. Let. and others associated with it stay have baseling convicts for these

FEC

Access this tedicalous should eat into profitable invenues with an acceptant offer by universal service. RECCs will need to may on States for rebalancing or state the universal service famils. On the positive side, the marker was esting into the high end business access and would overmally bring down rates with no rebalancing. Flut runs will case some of the creats stimuling.

Net Net	(4) The PCC is constituting remains just as incomes universal service that which would be smaller than emercity expected. Incring it up to the individual reason to deal with the incomes persies of the facel.	(2) The manicaling season chapper could be driven down formy then originating werest charges about them in process makes present (se compatition) on originating than on wandsofing second (successed don't charge who wandshippes that calls).	(2) As secure charges are delves down, some ways hand charges that the LBCs contently positive from long distance carried will be convented to first part charge.	(1) Assess sudeclarat will be a combination of no uplimat out (parallely \$1-92 hillion) and a standarding to drive down a per december of days (i.e. 3-5 yes)	
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Telecommunications Services (I/TEL): Meeting With the PCC
Stephanic Confort (303) 740-6695
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MORGAN STANLEY Equity Research Briefing Note

WAIT, BELL BLS. FON. GST, ICIX, ICIG, IIXC, MCIC, MCLD. NYN, PAC, SBC, T, TCGI, USW. WCIL, WCOM, US Telecommunications Services (I/TEL): Meeting With the PCC Suphanic Confort (303) 740-6695 Peter Kannedy (212) 761-8033

Date: Murch 5, 1997 Type: Industry Overview

KEY POINTS

Yesterday we met with the PCC to discuss access reform and universal service. The PCC was looking for Wall Servers aspectations and reactions to various outstands.

Although the process is still fluid, we believe this marring combined with our interpretation of Chairman Reed Hundt's recent speech to the National Association of Regulatory Utility Commissioners has given us a better sense, directionally, of where the Commission is going.

As you recall, the 1996 Telecom Act required that the Universal Fund, an explicit subsidy fund, he enhanced to support telecommunications services for low income households, high cost agess and subsidize public schools, libraries esc. Today these subsidies are primarily achieved through implicit support machanisms (access revenues). The goal of the PCC has been to restructure the support mechanisms from implicit to esplicit subsidies. This is why access reform and universal service are so injust wined.

Accus Referen.

According to FCC reports, in 1995 there was \$31B for in access charges poid to the local exchange providers. This consists of \$7.1B in orderer revenue with the remaining \$24b from switched and special access. Switched access revenues are derived from originating and terminating per minute access charges paid by the inter exchange carriers (DKCs). Today, traffic sensitive scenes rates are just below \$0.03 per minute. Those acress rates have historically never been based on cost but have been used to subsidize other high ones components of the local network. The FCC intends to drive inter-state access states down to cost over some time period.. With surrout astimoses for forward

looking sconomic costs coming in at \$0.004-\$0.01. There is a significant gap butween current mriffs and cost projecti bas.

We believe this reform will be realized through two methodi: restructuring and straight reductions.

Restructuring - One of alternatives mentioned was to convertivationic carrier common line (CCL) charges into fixed like charges. A persion of access rates today (\$0.004-30,02) are what are known as carrier common line charges. These charges were created to support the high cost of the local loop. Although the charges are traffic sensitive, the actual costs are not traffic sensitive and should indeed be a fixed cest. Instead of paying a per minute charge, LD provide's will pay a fixed cost per pro-subscribed line.

Implications

- We billove this benefits Long Distance Providers aspenially those with high end customers. By placing a greater partion of variable cost into fixed costs. Interexthance providers will be able to other prise incentives to stimillate volume demand while keeping a granter partice. of the ches fixed.
- For the CLECS, we believe this is slightly asgetive in the short with. By placing more of the revenue into fixed per line revenues, it disjuctors the cream akimming of high end
- This restructuring is slightly favorable for the RBOCs because this does distancent cream skimming but it also reduces the benefit of access volume growth in the activoric

Reductions -

studium is based on information available to the public. No reprosentation to leade that is in assuring or assuring to it to buy or sell or a saliciation of an olice to buy or sell the naturalists resoluted. It began Stanley & Co. Inc. and educe essects ideas in and office transactions in according of companies mentioned and may also perform or sank to perform investment bundle offer to buy or sell or a solicion

We use believe there will be substantial reductions in access rates driving the staffic sensitive portion down to \$0,005-\$0.01 range over the next three to five years. We believe that these rates will be reduced through a standard of regulatory case and prescribed minimums for B market based reduction, with particular emphases on we

Implications

RESIDENCE SOCIETY

- Again this is a positive for the long distance providers to the extrest retail prices remain science and do not decline as fast as seems.
- For the CLECs this is a slight nagative because of their caditional CAP beniness which relied beavily on access rate. The CLEC or Dial come business is less impacted because of the diverse revenue sections of lotal, roll and naces.
- The RDOCs should feel present thom any eignificant out in access. It is their most profitable sevents, with 80% + margias. To the extent that the secret reductions are not supplemented with Universal Service payments, these reductions will virtually all fall to the bottom line.

Universal Service Fund

The exact size of the fund has yet to be descriziond, but it appears to be selectedably less than the present implicit fund. Currently the Commission settlesses that there is \$2.78 in access charges that are flowing to Incombent local exchange carriers (ILECs) from ECCs. The constanton that has arisen is how much of the access revenues go towards real costs and how large should the new explicit substity to: The ILECs believe they should be loopt whole or close to whole, while the DECs think the explicit fund should be \$5-108. We believe the Suest is anticipating the fund will end up in the \$108-158.

The FCC is currently in negatiations with the State PUCs on just how to approach the fund. Will there be two separate funds (Instructus and Insertate) or one large universal fund? The FCC's position today, is that unless there is consensus senoug the States, the FCC will just two un interreas universal fund and let the States fund for themselves on the shortfalls. We believe the FCC is a bit sky after the State shortfalls.

lawarite over the interconnection rules but we sign believe this is a bit of posturing by the RCC. The rural states with less telepommunications revenues and higher costs structures would be better off with one Federal Fund. Because of the revenue concentration in the top 10 states, we believe that the majority of States would benefit from one central fund.

Fixed Charge - With the reductions in account, the FCC has to derive another payment mechanism to support the universe fund. The machanism that is currently being discussed is a flat rare, called the flat and equitable race charge (FEBC), based on pre-subscribed lines. The charge will probably not be equal for all lines, multi-lines and second inter will probably have premiums attached.

FCC uses Inscrince Revenues to Fund the Fuderal Portion of Universal Funds. If the FCC goes with only Insertiate revenues, no local or instructate revenues will be affected (named) by the FCC Fund.

No. I

If the FPIC remains on its present track, with the interstate fund only, we could see the ILECs' subsidy pool strink by SSB to \$108 over the next five years. This does not account for any clasticity/growth in the market or any fixte support machanisms.

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LD players appear to be the winners in access referin.

Author; the timing and magnitude is still unclear, we believe that not payments to the ILECS will decline.

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Equity Research Broadcast - All Offices Code: A

Analyst: Frank J. Governali, CFA Industry: Telecom Services Telephone: (207) 780-6210 Date: March 10, 1997

Industry:

Telecom Services

Subject:

Moeting with FCC Staff & Chairmen To Discuss Access Reform and Universal Service

Retinge:

No Change

Summery

On May 8 the FCC must issue its order on Access Charge Reform and Universal Service funding. The FCC wants to keep the Street's expectations in line with reality, and to insure it is aware of expectations - thus meetings have been conducted with the Street. The FCC is not telling people what it intends to do, but rather reviewing the various options. Our meeting yesterday provided no basis to change our current view on access charge and universal service reform: we continue to believe that access reform will trim annual LEC revenues by \$5 to \$7 billion (not), by the end of a 3 to 5 year transition period. Universal service fund would be \$6 to \$8 billion. Reformed access charges will be comprised of fixed per-line charge, combined with usage sensitive fee.

- Meeting with FCC Staffers with brief visit by Chairman Hundt, Yesterday, February 26, we, along with four other sell-siders, met with FCC senior staffers and briefly with Chairman Reed Hundt. The avowed purpose of the masting was to gauge the especiation of Wall Street to various policy options in the FCC arsenal regarding access reform and universal service. The FCC has been holding these meetings, and will hold others, to ensure it is adequately considering all options in its policy development, and to insure the Street is not in left field as it relates to expected outcomes. This is a smart move by the FCC, of course assuming, federal policy is not being dictated by stock prices - which of course it is not. By May 8 the FCC is required to come up with its order on access charge reform and universal service funding. The task is daunting and the implications profound for the industry. These issues get at the very heart of U.S. telecom policy and will be two of the prime determinants of whether or not competition successfully ensure the local arona. (The others are the interconnect rules and the timing of RBOC entry into long distance.)
- Hundt Lays Out Policy Principles In Presentation to NARUC On February 25. On Tuesday Chairman Hundt presented and outline of policy priorties and principles to the National Association of Regulated Utility Commissions. It is useful to consider his points, because it was this speech that was the backdrop for our discussion with the FCC officials on Wednesday. First, Hundt reinforced the notion that access charges need to get down to forward looking costs. Second, that the recovery of costs had to be done on a basis that encouraged competition and reflected the economic incurrence of cost. Thus, he supported the joint Board recommendation to collect access on both a fixed and variable basis - a fixed monthly per line charge combined with a lower usage element. Third, he reconfirmed his position that the LECs should not be assured of fully recovering historic costs in access reform or interconnection. Fourth, he reconfirmed his commitment to a transitional implementation of reduced access charges (not a dislocating flush cut).
- No suggestion of revenue neutral reform of access charges. Recently there have been stories circulating that access reform will and up being a "revenue-neutral" transition for the LECs. We definitely did not hear this yesterday. There can be several interpretations of what revenue neutral means. By our definition, it means that access charges themselves are changed in such a way as to not effect the net revenue collected for access. Thus, based on our discussion yesterday, we continue to believe that access charges will be out, producing a net reduction in revenue to the LECs on an annual basis of \$5 to \$7 billion by the end of a three to five year transition period. We expect the 1997 cut, and subsequent additional cuts to total \$1 to \$2 billion, adding up to the total \$5 to 57 billion.

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We have not and do not view this level of access cuts to be dramatic. This level of cuts is in line with the revenue reductions absorbed by the LEC industry in their annual price cap adjustments. This level of cuts certainly holds down revenue growth, but it in no way compromises their ability to fund capital investment and maintain the local networks, which is a key concern of regulators and politicians.

The FCC is committed to changing the way access charges are collected. The agency wants to make the method of collection more reflective of the way in which costs are incurred by the LECs. Thus, it wants to get away from collecting the access charges purely on a usage sensitive basis. The FCC is supporting the Joint Board's recommendation to make access charge collection a combination of a fixed monthly per line fee, and a smaller usage sensitive component. Just as access charges today are collected directly from the long distance carriers, these newly formulated access charges will soil be collected directly from long distance carriers. And, just as long distance carriers make their own decisions today on how to recover their access costs in pricing to end users, they will do the same in the future. Thus, if the per line charge ends up being \$2 per month for standard telephone lines, (a reasonable level) the long distance carriers would be able to make the choice whether to pass this fee directly to consumers, or to some how mask it in their long distance rates.

- Implications of A Fixed Per Line Charge Combined With a Usage Sensitive Component. The change in the way access charges are collected has positive and negative consequences for both LECs and new entrants. For the LECs, the positive is that it will remove some of the opportunity for competitors to cherry pick high end customers, who generate a lot access revenues through long distance calling. The negative is that with a smaller usage sensitive charge the LECs won't enjoy as much of a revenue pick-up with volume growth. For CAPs the new regime would take away some of the opportunity for cherry picking at the top. But as Reed Hundt said yesterday: "we want to turn CAPs into CLECs" (Competitive Local Exchange Carriers.) The opportunity for CLECs remains undiminished by this change. Similarly, for long distance carriers, eager to become CLECs this change would not be significant. For long distance carriers the key issue is the size of the access revenue cut, not so much its distribution. However, if long distance carriers have to pay a high perline fee, then very low end oustomers become unattractive. If a current pre-subscribed customers makes little to no long distance calls, than the carrier will want to drop this customer, since the revenue might not even cover the par line fee.
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Excerpts From The Chairman's Speech: we've lifted quotes from Reed Hundt's speech below. We think these comments can help understand the FCC's current position on a variety of topics.

Pro-Competition ... means we want to promote all competitions and competitive strategies. even-handedly and indefferently, as opposed to following the United Kingdom model and promoting specifically and unevenly alternative infrastructure development by the cable industry, or a single facilities-based long distance carrier like Mercury

Our choice of being pro-competition instead of being pro-any specific competitor is why we at the state and federal level are supposed to guarantee all three of the basic rights of new entrants under the Act: buying at wholesale, leasing elements, and interconnecting from new facilities. Effective enforcement of all three rights is necessary to expedite the entry of new competitors into the local exchange and access markets.

Our vigilance in enforcing these rights is essential because the scope of the challenge facing new entants is quite broad. In every single existing service territory the market is dominated by one company - the historic monopolist.

... I think that our target is clear; over time lowering traffic sensitive interstate access charges to forward looking cost and restructuring the cost recovery such that prices charged

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competitive market and thus we should seek to emulate this result in the absence of such competition. Where and when the murket for a particular access sergice is workably competitive, access prices should be set by them when, not by government. The big question in access reform it not our target, but how — and how fast—we get there.

This inefficient pricing (of access) discourages broad entry by new entrants (because revenues are concentrated in high volume users) and deters usage of lang distance (because is is priced artificially high).

To get from where we are today to where we would like to be, the Joint Bourd thought we should move some traffic sensitive charges to flat rate charges imposed on IXCs by the LECs. We're calling this the flat and equitable rate charge or FERC...

... We still have to decide how much usage-based charges should be reduced on what we call Day One, the effective date for the changes in our access reform order, and how long we shold take to phase in the rest of the reduction required to get to forward looking costs.

Nor is it obvious that FERC ought to be imposed on all access lines.

be terms of rate levels, we may wish to have different approaches for originating and terminating access charges. There seems to be broad conseques among economists that originating access rates will experience significantly more market pressure than terminating access.

The combined effect of the changes I'm discussing here todayis to take a significant step toward getting access charges to cost immediately, with the bulk of additional reductions coming later, over time.

As to future access reductions, it will be critical to set in motion a predictable process in our order that will reduce access to forward looking economic cost within a reasonable time period.

...we also intend to address the question of LBC recovery of historic costs...! do not believe however, that we shol dbegin the inquiry into the historic cost issue with the supposition that the LEC is necessarily guaranteed as a matter of law a complete certainty of recovering al such investment. Takings is certainly one of our concerns here, but we must not forget "givings". Let me mention three: first, giving the LECs cellular ficenses worth billions; second, giving LECs yellow pages publishing opportunities (also worth billions); and third giving LECs the opportunity to enter long distance, where they can leverage their regulated local asset.

No. 8170; 333p. 27:3/13

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Equity Recearch Breadcast - All Offices Code: A

Analyst: Frank J. Governali, CFA industry: Telecom Services Telephone: (207) 720-6218 Date:March 10, 1997

industry:

Telecom Services

Subject:

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Our vigilance in enforcing these rights is essential because the scope of the challenge facing new entants is quite broad. In every single existing service territory the market is dominated by one company - the historic monopolist.

...! think that our target is clear: over time lowering traffic sensitive interstate access charges to forward looking cost and restructuring the cost recovery such that prices charged

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We have not and do not view this level of access cuts to be dramatic. This level of cuts is in line with the revenue reductions absorbed by the LEC industry in their annual price cap adjustments. This level of cuts certainly holds down revenue growth, but it in no way compromises their ability to fund capital investment and maintain the local networks, which is a key concern of regulators and politicians.

The FCC is committed to changing the way access charges are collected. The agency wants to make the method of collection more reflective of the way in which costs are incurred by the LECs. Thus, it wants to get away from collecting the access charges purely on a usage sensitive basis. The PCC is supporting the Joint Board's recommendation to make access charge collection a combination of a fixed monthly per line fee, and a smaller usage achsilive component. Just as access charges today are collected directly from the long distance carriers, these newly formulated access charges will still be collected directly from long distance carriers. And, just as long distance carriers make their own decisions today on how to recover their access costs in pricing to end users, they will do the same in the future. Thus, if the per line charge ends up being \$2 per month for standard telephone lines, (a reasonable level) the long distance carriers would be able to make the choice whether to pass this fee directly to consumers, or to some how mask it in their long distance rates.

- Implications of A Fixed Per Line Charge Combined With a Usage Sensitive Component. The charge in the way access charges are collected has positive and negative consequences for both LECs and new entrants. For the LECs, the positive is that it will remove some of the opportunity for competitors to cherry pick high end customers, who generals a lot access revenues through long distance calling. The negative is that with a smaller usage sensitive charge the LECs won't enjoy as much of a revenue pick-up with volume growth. For CAPs the new regime would take away some of the opportunity for cherry picking at the top. But as Reed Hundt said yesterday: "We want to turn CAPs into CLECs" (Competitive Local Exchange Carriers.) The opportunity for CLECs remains undiminished by this change. Similarly, for long distance carriers, cager to become CLECs this change would not be significant. For long distance carriers the key issue is the size of the access revenue cut, not so much its distribution. However, if long distance carriers have to pay a high perline fee, then very low end customers become unattractive. If a current pre-subscribed customers makes little to no long distance calls, than the carrier will want to drop this customer, since the revenue might not even cover the per line fee.
- Implications For Stocks. We continue to believe the growth outlook for the RBOCs is a 3% to 7% growth rate. This is based on the level of access cuts described above, entry into long distance in the second half of 1998, and competitive pressures starting in the second half of 1997. With this outlook, we think the RBOCs have gotten ahead of themselves recently. On the long distance side, there is no "group call." Its company specific. This is also true for the CLECs. Companies that can operate successfully in the current environment, and transition successfully to full service operators will be winners.

Excerpts From The Chairman's Speech: we've lifted quotes from Reed Hundt's speech below. We think these comments can help understand the FCC's current position on a variety of topics.

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competitive markes and thus we should seek to emulate this result in the absence of such competitive. Where and when the murket for a particular access sergice is workably competitive, access prices should be set by them orket, not by government. The big quustion in access reform is not our target, but how – and how fast—we get there.

This inefficient pricing (of access) discourages broad entry by new entrants (because revenues are enacentrated in high volume users) and deters usage of lang distance (because it is priced artificially high).

To get from where we are today to where we would like to be, the Joint Board thought we should move some straffic sensitive charges to flat rule charges imposed on IXCs by the LECs. We're calling this the flat and equitable rate charge or FERC...

... We still have to decide how much usage-based charges should be reduced on what we call Day One, the effective date for the changes in our access reform order, and how long we shold take to phase in the rest of the reduction required to get to forward looking costs.

Nor is it obvious that FERC ought to be imposed on all access lines.

In terms of rate levels, we may wish to have different approaches for originating and terminating access charges. There seems to be broad consensus among economists that originating access rates will experience significantly more market pressure than terminating access.

The combined effect of the changes I'm discussing here today is to take a significant step toward gazing access charges to cost immediately, with the bulk of additional reductions coming later, over time.

As to future access reductions, it will be critical to set in motion a predictable process in our order that will reduce access to forward looking economic cost within a reasonable time period.

...we also intend to address the question of LEC recovery of historic costs...! do not believe however, that we shall begin the inquiry into the historic cost issue with the supposition that the LEC is necessarily guaranteed us a matter of law a complete certainty of recovering al such investment. Takings is certainly one of our concerns here, but we must not forget "givings". Let me mention three: first, giving the LECs cellular licenses worth billions; second, giving LECs yellow pages publishing opportunities (also worth billions); and third giving LECs the opportunity to unter long distance, where they can leverage their regulated local asset.

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Analyst: Frank J. Governali, CFA industry: Talecom Services Telephone:(207) 780-6210 Date: March 10, 1997

industry:

Telecom Services

Subject:

Mooting with FCC Staff & Chairman To Discuss Access Reform and Universal Service

Ratings:

No Change

On May 8 the FCC must issue its order on Access Charge Reform and Universal Service funding. The FCC wants to keep the Street's expectations in line with reality, and to insure it is aware of expectations - thus meetings have been conducted with the Street. The FCC is not telling people what it intends to do, but rather reviewing the various options. Our meeting yesterday provided no basis to change our current view on access charge and universal service reform: we continue to believe that access reform will trim annual LBC revenues by \$5 to \$7 billion (net), by the end of a 3 to 5 year transition period. Universal service fund would be \$6 to \$8 billion. Reformed access charges will be comprised of fixed per-line charge, combined with usage sensitive fee.

- Meeting with FCC Staffers with brief visit by Chairman Hundt, Yesterday, February 26, we, along with four other sell-siders, met with FCC senior staffers and briefly with Chairman Reed Hundt. The avowed purpose of the meeting was to gauge the expectation of Wall Street to various policy options in the FCC arsenal regarding access reform and universal service. The FCC has been holding these meetings, and will hold others, to ensure it is adequately considering all options in its policy development, and to insure the Street is not in left field as it relates to expected outcomes. This is a smart move by the FCC, of course assuming, federal policy is not being dictated by stock prices - which of course it is not. By May 8 the FCC is required to come up with its order on access charge reform and universal service funding. The task is daunting and the implications profound for the industry. These issues get at the very heart of U.S. telecom policy and will be two of the prime determinants of whether or not competition successfully enters the local arona. (The others are the interconnect rules and the timing of RBOC entry into long distance.)
- Hundt Lays Out Policy Principles In Presentation to NARUC On February 25. On Tuesday Chairman Hundt presented and outline of policy priorties and principles to the National Association of Regulated Utility Commissions. It is useful to consider his points, because it was this speech that was the backdrop for our discussion with the FCC officials on Wednesday. First, Hundt reinforced the notion that access charges need to get down to forward looking easts. Second, that the recovery of costs had to be done on a basis that encouraged competition and reflected the economic incurrence of cost. Thus, he supported the joint Board recommendation to collect access on both a fixed and variable basis - a fixed monthly per line charge combined with a lower usage element. Third, he reconfirmed his position that the LECs should not be assured of fully recovering historic costs in access reform or interconnection. Fourth, he reconfirmed his commitment to a transitional implementation of reduced access charges (not a dislocating flash cut).
- No suggestion of revenue neutral reform of access charges. Recently there have been stories circulating that access reform will and up being a "revenue-neutral" transition for the LECs. We definitely did not hear this yesterday. There can be several interpretations of what revenue neutral means. By our definition, it means that access charges themselves are changed in such a way as to not effect the net revenue collected for access. Thus, based on our discussion yesterday, we continue to believe that access charges will be out, producing a net reduction in revenue to the LECs on an annual basis of \$5 to \$7 billion by the end of a three to five year transition period. We expect the 1997 cut, and subsequent additional cuts to total \$1 to \$2 billion, adding up to the total \$5 to \$7 billion.